

Varnabas Museum Hotel Private Limited: Ratings placed on Watch with Negative Implications¹

January 30, 2023

Summary of rating action:

Instrument* (Limits in NPR Million)	Last Rated Amount	Current Rated Amount	Rating Action
Long-term loan; fund-based	536.74	536.74	[ICRANP] LB@; placed on Watch with Negative Implications
Short-term loan; fund-based	10.00	10.00	[ICRANP] A4@; placed on Watch with Negative Implications
Total	546.74	546.74	

*Instrument details are provided in Annexure-1

Rating action

ICRA Nepal has placed the ratings of Varnabas Museum Hotel Private Limited ('Varnabas' or 'the company') on Watch with Negative Implications, as indicated by long-term rating of [ICRANP] LB@ (pronounced ICRA NP L B) and a short-term rating of [ICRANP] A4@ (pronounced ICRA NP A four) respectively.

Rationale

The ratings Watch with Negative Implications is mainly on account of the intensified project execution risks as the company's debt servicing obligations has already commenced *from December 2022 (after a 3-year moratorium period for initial loan limit)*, while the proposed hotel project is still under construction with ~62% financial progress as of mid-November 2022. Hence, the company's liquidity is likely to remain stressed over the near term, which may be further accentuated by any unexpected time and cost overruns towards project completion. In this backdrop, ICRA Nepal expects timely and adequate funding support from the promoter to aid the company's cash flow shortfalls (for remaining capex and near-term debt servicing) and any delays herein would have a bearing over the ratings assigned.

Further, the ratings continue to remain constrained by the project's high debt burden (*debt to equity D:E ratio of 69:31*) over a relatively small scale of operations (*48 keys*). This is likely to create liquidity pressures on the company upon commencement of operations, impacting the coverage and profitability indicators, and the project's stabilization timeline as well. The ratings also remain constrained by the limited experience of the company's promoter in operating a high-end hotel, despite having tourism sector related experience of over two decades. Additionally, the competitive intensity of the industry and the hotel's limited segment and geographical diversification continue to remain the key rating concerns.

Nonetheless, the ratings consider the promoter's traction among industry stakeholders and prospective customers, which is likely to aid the project's prospects and contain some of its off-take risks. The central location of the property is also expected to support footfall and occupancy rates. The rating also favourably factors in the Government of Nepal's (GoN) initiatives to boost the tourism industry, supporting demand for such (hospitality sector) projects. Going forward, the company's ability to complete the project within the stipulated time and costs, and the extent of funding support from the promoter until the project achieves stabilization, will remain as the key rating monitorable.

Key rating drivers

Credit strengths

Strategic project location and promoter's prior experience in the tourism sector - The proposed 4-star hotel property is centrally located in the Gairidhara-Baluwatar area, which is close to major landmarks in the capital city Kathmandu. This is expected to augur well for the offtake prospects of the hotel. Additionally, the company's sole promoter has been

¹ Please refer [here](#) for details on rating watch and its meaning/implications.

involved for more than two decades in the tourism industry via. travel and tour operations and has developed a good traction amid various stakeholders and potential clients. These factors could help mitigate the hotel's off-take risks to a certain extent.

Government's support for the tourism sector players - The GoN has taken positive steps to encourage private sector involvement in the tourism sector through provisions like tax holidays for large-scale hotel projects, a lending floor for banks and financial institutions (BFIs) for tourism-related projects, among others. Though the effect of Covid-19 pandemic (albeit waning) and the impending global economic slowdown could impact the hospitality and tourism sector, the longer-term outlook remains positive.

Credit challenges

High execution risks amid slow pace of development and commencement of loan servicing - The project construction started from September 2019 with the management then targeting the project commissioning by first half of 2021. However, the project's financial progress was only ~62% as on mid-November 2022 and the management's revised estimate for commissioning is by June/July 2023. Amid the largely Covid induced construction delays, the moratorium for initial loan limit (~NPR 537 million) has already ended and the loan servicing²(*principal and interest*) has started from December 2022, which is likely to put additional pressures on the liquidity needs for project commissioning. Given the pertinent phase of project development, timely commissioning of the hotel project within the expected budget would remain crucial.

High leverage and limited economies of scale could result in stretched liquidity and weak debt servicing ability - The project has been undertaken at a D:E of 69:31 (initially planned at 75:25), which remains on a fairly higher side considering the cyclical/seasonal nature of the industry. This, coupled with the small scale of operations of the hotel (48 keys), renders the project highly leveraged in terms of capital structure as well as of the expected operating profitability during the early years. The cost per key of the hotel remains high at ~NPR 23 million (previously ~NPR 13 million) and is susceptible to further increase in the event of any unanticipated cost overruns. Until the hotel's operations stabilize, the RevPAR (Revenue Per Available Room) level is expected to remain moderate, affecting the OPBDITA levels. With a high debt burden vis-à-vis operation levels, the liquidity is expected remain under stress and affect Varnabas' debt repayment capacity. The project is expected to remain weak as regards its debt coverage indicators during the early years, and the promoter's ability to timely inject funds will have a bearing on the hotel's debt repayment ability during those years.

Increasing competition among star hotels, and limited geographical and segmental diversification of the project - The competition in Kathmandu's hotel industry is gradually increasing, which is further expected to increase as many additional projects are in the pipeline. The country's hotel industry in general is waiting for a boom in tourism following the pandemic era and most players are already taking steps in anticipation of a golden period after a period of slowdown, which is likely to intensify the competition even more. The proposed hotel will be a single property in Kathmandu, and its geographical and segment diversification remains low. The prospect of the hotel, therefore, will depend on the improvement of foreign tourist arrivals and the hotel's ability to compete with established players as well as new entrants (with or without affiliation to reputed brands).

Analytical approach: For arriving at the ratings, ICRA Nepal has applied its rating methodology as indicated below:

Links to applicable criteria:

[Corporate Credit Rating Methodology](#)

Link to the previous rationale

[Rationale Varnabas Museum Hotel Private Limited-August 2021](#)

² The debt funding provided to Varnabas is based on capitalization of interest during the moratorium period pertaining to each of the two Term Loan limits- original and additional, interest servicing is to commence from the quarter end thereafter.

About the company

Incorporated in June 2018, Varnabas Museum Hotel Private Limited is a special purpose vehicle (SPV) that will own and operate a proposed 4-star hotel. The proposed hotel will be themed around various ethnicities (aka 'Varnas' in the local language) of Nepal with different floors representing the artefacts and lifestyles of particular ethnic groups. Varnabas is the first hotel project of Mr. Rajendra Bajgain, a tourism sector entrepreneur with over 20 years of experience. The project is currently under-construction with ~62% financial progress as of mid-November 2022, and the management is targeting to commence operations from June/July 2023.

Annexure-1: Instrument Details

Instrument (Amount in NPR Million)	Previous rated limits	Current rated limits	Rating assigned
Fund Based - Term Loans- Original limit	536.74	536.74	[ICRANP] LB@; placed on Watch with Negative Implications
Fund Based- Short-term Loans (Overdraft)	10.00	10.00	[ICRANP] A4@; placed on Watch with Negative Implications
Total	546.74	546.74	

Analyst Contacts:

Mr. Sailesh Subedi (Tel No. +977-1-4419910/20)
sailesh@icranepal.com

Mr. Rajib Maharjan (Tel No. +977-1-4419910/20)
rajib@icranepal.com

Ms. Neha Baral (Tel No. +977-1-4419910/20)
neha@icranepal.com

Relationship Contacts:

Ms. Barsha Shrestha (Tel No. +977-1-4419910/20)
barsha@icranepal.com

About ICRA Nepal Limited:

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Our parent company, ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency. Today, ICRA and its subsidiaries together form the ICRA Group of Companies.

For more information, visit www.icranepal.com

ICRA Nepal Limited,

Sunrise Bizz Park, 6th Floor, Dillibazar, Kathmandu, Nepal.

Phone: +977 1 4419910/20

Email: info@icranepal.com

Web: www.icranepal.com

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